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72-1129

AD HOC GROUP ON ECONOMIC
POLICIES TOWARD EASTERN EUROPE

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February 1, 1973

MEMORANDUM FOR MESSRS. HENRY A. KISSINGER
AND PETER M. FLANIGAN
THE WHITE HOUSE

Subject: Economic Policies Toward Eastern
Europe (NSSM 163, CIEPSM 24)

The Ad Hoc Group submits herewith the comprehensive review of the issues involved in further normalizing our economic relations with the countries of Eastern Europe which you requested on October 27, 1972.

The Department of Defense has requested that its final comments be attached to the study.

Walter T. Stoessel, Jr.
Walter T. Stoessel, Jr.
Acting Chairman

Attachments:

1. NSSM 163/CIEPSM 24.
2. Defense Comments.

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GDS--DECLAS. DEC. 31, 1980

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E.O. 12958, as amended

June 19, 2008

February 1, 1973

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Economic Policies for the Eastern European Countries

Section One

- I Summary and Conclusions
- II US Interests and Objectives and Underlying Determinants of US Policy
- III Consequences for US-East European Relations of the Improved US-Soviet Relations
- IV Economic Profile, Eastern Europe
- V General Directions and Limits to US Economic Policy
- VI Negotiations

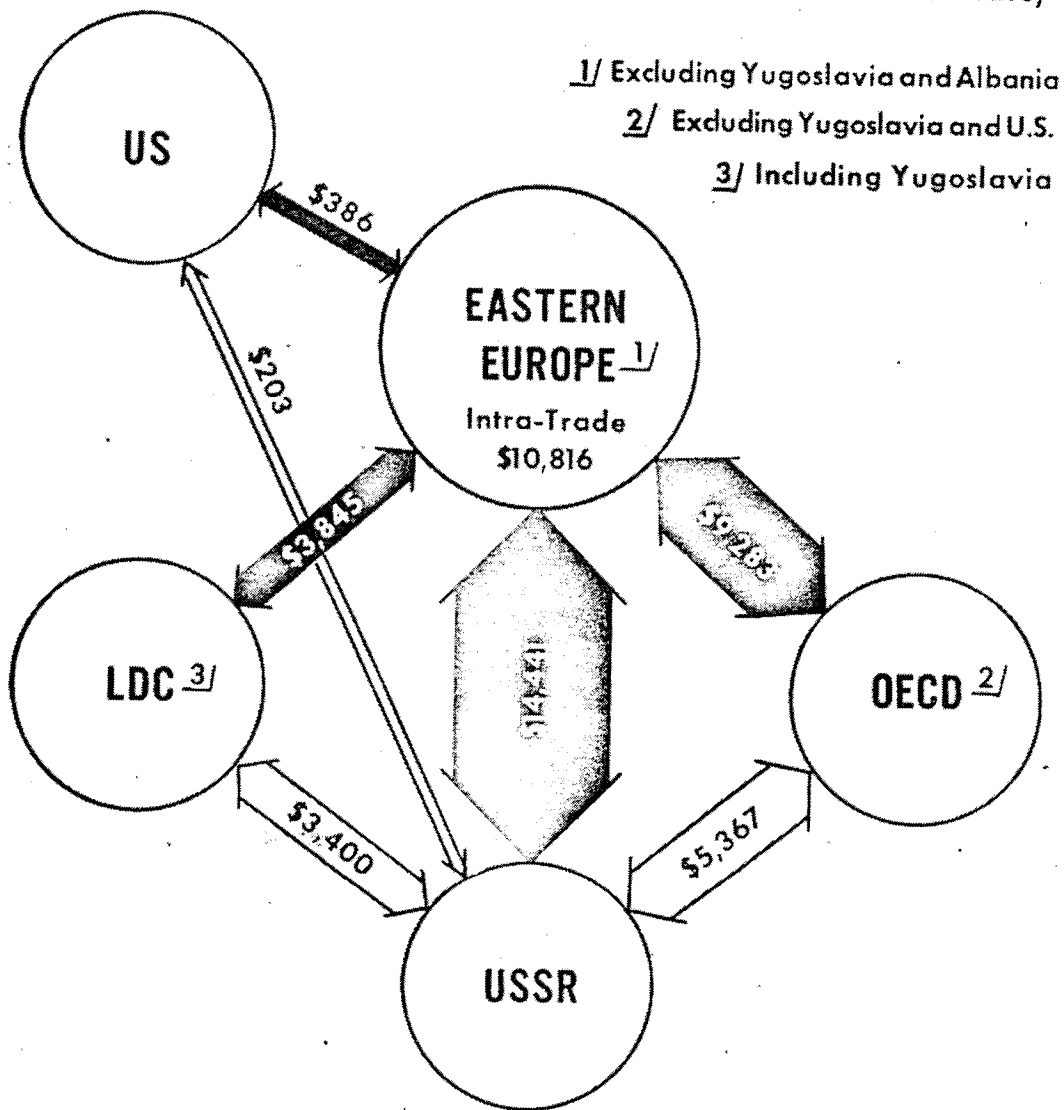
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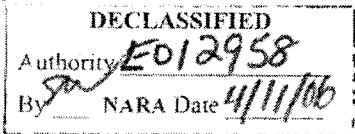
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MAJOR EASTERN EUROPEAN TRADING RELATIONS - 1971
(Turnover in millions of dollars)





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I. SUMMARY AND CONCLUSIONS

A. Introduction

In National Security Study Memorandum 163 and Council on International Economic Policy Study Memorandum 24, the President requested from the Secretary of State, Treasury, Defense, Agriculture and Commerce, the Special Representative for Trade Negotiations, and the Director of Central Intelligence "a comprehensive review of the issues involved in further normalizing our economic relations with the countries of Eastern Europe," defined as including all Eastern European Warsaw Pact members plus Yugoslavia and Albania. The German Democratic Republic (GDR) is included in the terms of this study.

As requested, an Ad Hoc Group of representatives of these organizations and of the Assistant to the President for National Security Affairs and the Assistant to the President for International Economic Affairs, chaired by a representative of the Secretary of State, has prepared the attached study.

The principal recommendations of the study are as follows:

1. Negotiations should begin without delay with Romania and Hungary to reach agreements on commercial practices and facilities so that agreements embodying MFN can be implemented quickly after Congress has granted the President authority to negotiate MFN. Both nations should be informed that reaching satisfactory settlements of defaulted pre-war bonds will be prerequisite to receiving MFN and, in Hungary's case, ExIm facilities. State and Defense favor telling the Hungarians that successful parallel negotiation of a cultural and scientific exchanges agreement will facilitate action on MFN and telling the Romanians that freer issuance of emigration visas to divided families and a reasonable price for a chancery site will facilitate MFN action.

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2. Assuming the initiation of promising consular negotiations with Bulgaria and Czechoslovakia, linked negotiations of commercial and financial issues should begin without delay with these two countries. State and Defense would prefer to have the financial negotiations begin first and reach a promising stage before initiating negotiation of commercial issues. They would also prefer that negotiations of appropriate agreements on cultural and scientific exchanges reach a promising stage before beginning either commercial or financial negotiations.

3. With regard to the GDR, efforts to improve trade should be continued and increased as circumstances permit, but there can be no formal negotiation of claims or comprehensive commercial agreements until diplomatic relations have been established.

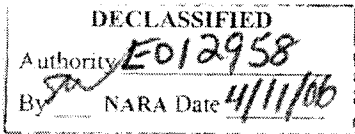
4. No major negotiations on economic/commercial issues with Yugoslavia are now needed, while those with Poland have already been programmed by the Polish-American Commercial Commission. With Albania, no negotiations are recommended until after diplomatic recognition which is not anticipated prior to the achievement of Presidential authority to negotiate MFN.

5. It is recommended that economic negotiations include the following issues: MFN (including where appropriate, market disruption), business facilitation, arbitration, individual property rights and copyrights, industrial cooperation, maritime issues, participation in East European trade fairs, export credits, and double taxation.

6. Recommendations emerging from consideration of NSDM 159 with regard to continuing review and reduction of the COCOM Export Control list and strengthening of the COCOM system should be promptly carried out. Except for Defense,* it is also recommended that there

* The DOD reservation is set forth in a footnote to export controls on page 17 in this summary.

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be continued movement away from the present US export control level and towards the COCOM level.

7. Repeal of the Johnson Debt Default Act should be sought.

B. US Interests

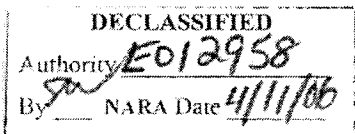
Primary US interests in the area covered by this study include:

-- a political and strategic interest in reducing the Soviet potential for action against US interests in Western Europe and, in some cases, other areas, (a) by sustaining a conviction on the part of the peoples and governments of Eastern Europe that the US, together with its Western European allies, sees them as a part of Europe and has not consigned them to a sphere of influence subject exclusively to Soviet definitions of sovereignty; (b) by favoring the gradual evolution of more independent external policies by states in this area to a degree which does not risk serious instability; (c) by nurturing the strong historical and cultural links the US has with many of the peoples of the area.

-- an economic interest in developing normal commercial relationships with states in the area both through joint ventures and the expansion of trade in order to (a) contribute trade and financial benefits; (b) support the closer contact of economies of these states with the West; and (c) encourage gradual trends toward less monolithic economic and consequently political systems which are less subject to Soviet control.

-- a military-strategic interest in maintaining the effectiveness of our deterrent strategy; providing the USSR with a continuing incentive for mutual balanced force reductions, and reducing US defense expenditures by restricting through the export control mechanism the export to close allies of the USSR in the area of certain types of strategic goods, services and advanced technology unobtainable elsewhere.

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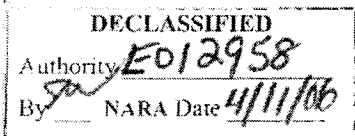
-- special interests distinct from our interests elsewhere in the area, which affect our posture towards the GDR: e.g. quadripartite rights in Germany, our position in Berlin, and the special FRG-GDR relationship. (These interests are elaborated in Section V, p.64.) We would not, for example, favor emphasizing GDR sovereignty vis-a-vis Soviet responsibilities as one of the four powers responsible for Germany.

C. Present Situation with Respect to the USSR

The Soviet Government like preceding Russian regimes has, in light of a series of invasions coming from the West, always regarded as particularly sensitive the zone lying between its major population and industrial concentrations in the Western regions of the USSR and the major centers of industrial and military power in Western Europe, Germany in particular. Since World War II it has been a primary Soviet interest to retain close control of this zone, particularly that part of it lying between the German-speaking Western states (FRG and Austria) and the USSR, i.e. Poland, Czechoslovakia, Hungary, and the GDR.

In 1968 in Czechoslovakia, the Soviets reiterated the lesson of Budapest 1956 - when the USSR sees its security threatened by developments in Eastern Europe, it is prepared to use military power to restore what it regards as an adequate degree of control. The Soviets, however, continue to struggle with the problem of defining their relations with Eastern European countries. The pressures within the area, the highly negative consequences of the invasion of Czechoslovakia in the international Communist movement, and the acceleration of Moscow's efforts toward detente in Europe has led the Soviets reluctantly to accept the markedly independent foreign policy of Romania (as well as that of Yugoslavia). They have also acquiesced in Hungary's considerable departure from the Soviet economic model and adopted hands-off policy when Poland faced a serious workers' strike in 1970. This

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range of tolerance apparently is deemed acceptable so long as the central authority of the national party apparatus in the country involved is not threatened.

The recent improvement in US-USSR relations leading to the US-USSR Commercial Agreement of October 18, 1972 has important implications for the countries of Eastern Europe. These countries have the same basic interests in improved economic relations with the US that the USSR has -- concern over the technological gap, respect for US technology and capital, fear of reduced markets in Western Europe as a result of the expansion of the European Economic Community, pressure from consumers, and a commitment to maintain high economic growth rates. The countries of Eastern Europe are distinct from the Soviet Union in that trade is more important to them, consumer expectations are higher, they have stronger traditional links with Western Europe, and they are concerned about the maintenance of their assured market in the Soviet Union for products which are difficult to market in the West or in developing countries. As illustrated by the forward movement in economic relations with Poland in 1972 and the productive November 1972 meeting at the Joint Polish-American Commercial Commission, the US has an interest in improved relations with Eastern Europe similar to that which it has in the case of the Soviet Union. The main difference is that the broad, world-wide interests of the US are not affected in the same degree in the case of Eastern Europe and the possibility of securing new sources of energy which exists in the case of the Soviet Union does not exist in the case of Eastern Europe. One result of the improved US-USSR relations is that US economic policies are now more liberal toward the USSR than they are toward Eastern Europe. The countries of Eastern Europe are conscious of this fact and are currently attempting to achieve the same status now accorded to the Soviet Union. Since the Soviet Union has led the way, it is now easier for the countries of Eastern Europe to take a more forthcoming stance toward improved economic relations with the US.

It is likely that the Soviets, having signed their commercial agreement with us in 1972, expect that these

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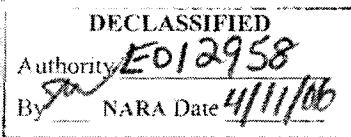
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Eastern European moves toward normalization of economic relations with the US will progress. It may be assumed that the Soviet Union has even stimulated or approved these overtures given the fact that the three most closely controlled Eastern European regimes, Czechoslovakia, Bulgaria, and the GDR, have all explicitly bid during the last quarter of 1972 for such normalization. By the same token it may be assumed that the Soviets, as illustrated by their negative reaction to the "human contacts" or "freedom of movement" element in the CSCE agenda and their renewed efforts to revive ideological defenses in Eastern Europe, will monitor closely the degree to which economic normalization is accompanied by cultural or even political normalization or a pace of internal reform which might threaten their very authoritarian view of the leading role of the Communist party in each country.

D. Eastern Europe and the US: Background

Although US interests in the area covered by this study have remained constant since World War II in view of the potential Soviet threat to Western Europe, the degree of emphasis on them has altered over time. In a period of essentially military confrontation dating from the Berlin blockade until Stalin's death, denial of economic or technological potential to the Soviet military was dominant. In the period of essentially political confrontation and maneuver since that time, encouragement to other Eastern European states to follow the example of Yugoslavia's independent posture has been a dominant interest, as illustrated most recently in the development of useful high-level contacts between the US and Romania. In the period ahead, while political confrontation and maneuver will continue, there is an opportunity to increase US influence throughout the area to some degree and to gain some modest trade and financial benefits by responding to what are apparently Soviet-authorized bids from the countries of the area for negotiation of normal economic relations. The normalization process can provide an opportunity to clear up long-standing claims and financial problems.

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The process can also facilitate negotiation where needed of an appropriate framework for consular and cultural relations which we have already with the USSR, Poland, Romania, and with the exception of certain consular problems, Yugoslavia.

There follows a chart showing how the countries of the area covered by this study rank with regard to certain key indices relevant to their present and potential significance to the US. The chart also lists the factors affecting bilateral economic relations with each country and the existence or non-existence of non-economic issues. These latter may be subject to resolution if, in the course of economic normalization, use is made of the increased economic leverage stemming from the interest in normalization of economic relations with the US recently expressed by all the countries not having MFN (Bulgaria, Czechoslovakia, Hungary, Romania, GDR) except for Albania.

The following chart also illustrates graphically the state of development of US relations with the countries covered by this study. Further descriptive background explaining the substantial differences among the countries suggested by the chart is present at the end of this summary chapter just after I H - Recommendations on page 27.

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STATUS OF BILATERAL RELATIONS

	POLAND	YUGOSLAVIA	ROMANIA	CZECHOSLOVAKIA	HUNGARY	GERMAN DEM. REP.	BULGARIA	ALBANIA
POTENTIAL MARKET FOR U.S. BY RANK ORDER	1975 1	2	3	4	5	6	7	8
	1980 1	4	5	3	6	2	7	8
MOST FAVORED NATION TREATMENT								
EXPORT IMPORT BANK CREDITS								
UTILIZED SIGNIFICANT CCC CREDITS IN PAST YEAR								
PL-480 SALE GENERATED CURRENCIES AVAILABLE								
MEMBERSHIP IN IMF, IBRD AND GENERAL LINKS TO WEST (RANK-ORDERED)	3			6	4	5	7	8
MEMBERSHIP IN GATT								
CIVIL AIR AGREEMENTS								
CLAIMS AGREEMENT								
BOND SETTLEMENT								
CULTURAL AND SCIENTIFIC EXCHANGES AGREEMENT								
CONSULAR CONVENTION								
IMPROVEMENT IN EMBASSY WORKING CONDITIONS								
DIPLOMATIC RELATIONS								
ADDITIONAL GOVERNMENTAL OFFICES								
REAL ESTATE PROBLEMS								

ECONOMIC ISSUES

NON-ECONOMIC ISSUES

RESOLVED

NO PROBLEM

RESOLUTION IMMINENT

UNDER NEGOTIATION

UNRESOLVED